

Introduction

The hospTrends Featured Topic this quarter is a look at the other operating income. The Featured Topic is where a financial or utilization category is given a slightly longer explanation. hospTrends reviews the current plus previous 12 quarters, which equals three years plus one quarter. To be consistent we use quarterly data for the entire time period even though actual fiscal year end data is available through 2004. Our web site information and a short description of the data we have available are at the end of the report.

Quarterly Quick Review

Below is a summary table of the statewide trends. The above average increase in the total number of discharges continues. Patient days had its largest percentage increase since 2001. Average length of stay was shorter than any year since 1998 though there is not a great variation from year to year in the ratio. The operating revenue grew at a slightly faster rate than operating expense so operating margin grew by 43.7% over the previous period. Operating expense grew by 8.2% which is within the annual percentage change range of the past 10 years which includes a low of 7.5% and a high of 10.9%. Charity care slowed its strong growth while bad debt rebounded from a recent decline.

Statewide Summary of Quarterly Reports

	4 Quarter Period Ending		Percent	2006
	3/31/2005	3/31/2006	Difference	Percent of Tot Rev
Discharges	532,200	546,510	2.7%	
Patient Days	2,286,306	2,326,656	1.8%	
Average Length of Stay	4.30	4.26	-0.9%	
+ Total Revenue	19,550,970,348	22,023,129,619	12.6%	
- Deductions from Revenue	10,020,870,479	11,595,193,951	15.7%	52.7%
= Net Revenue	9,530,099,869	10,427,935,668	9.4%	47.3%
+ Other Operating Revenue	609,947,401	668,999,511	9.7%	3.0%
= Operating Revenue	10,140,047,270	11,096,935,179	9.4%	50.4%
- Operating Expenses	9,797,086,689	10,604,206,476	8.2%	48.2%
= Operating Margin	342,960,581	492,728,703	43.7%	2.2%
+ Other Income/Tax Revenue	117,626,475	137,144,542	16.6%	0.6%
= Total Margin	460,587,056	629,873,245	36.8%	2.9%
Charity Care	439,166,005	531,538,976	21.0%	2.4%
Bad Debt	437,799,752	447,723,317	2.3%	2.0%
Operating Margin	3.38	4.44	31.3%	
Total Margin	4.49	5.61	24.9%	

Featured Topic

A brief explanation of hospital other operating income

Hospital "other operating income" is the actual dollars received by the hospital in its operations not directly related to patient care but related to operating a hospital. Such revenue can include non-patient food sales, non-patient room rental including medical office lease income, non-patient pharmacy sales, any reimbursement (rebates or refunds) including a physician remitting certain fees, transfer from restricted funds for current operations (not capital), sale of scrap and waste, and other numerous similar categories.

The amount of other operating income is significant to the financial health of many community hospitals in our state. Statewide, other operating income (OOR) is larger than the operating profit. In fact, without the other

operating income, the statewide operating profit would actually be an operating loss. For 2004 actual data, the latest full set of actual data available, 18 hospitals were able to have a positive operating margin because of other operating income, while 30 hospitals had an operating loss even with other operating income. The rest of the hospitals (46) had a positive operating margin even without the other operating revenue. 17 hospitals had OOR between \$44.6 million and \$9.9 million. 12 hospitals had OOR between \$6.8 million and \$2.9 million. 14 hospitals had OOR between \$2.6 million and \$1.2 million. 48 hospitals had OOR between \$850 thousand and \$4,000. Actual data was used to more accurately portray the effect of other operating income.

Other Operating Income (OOI) compared to Operating Profit which includes the effects of OOI

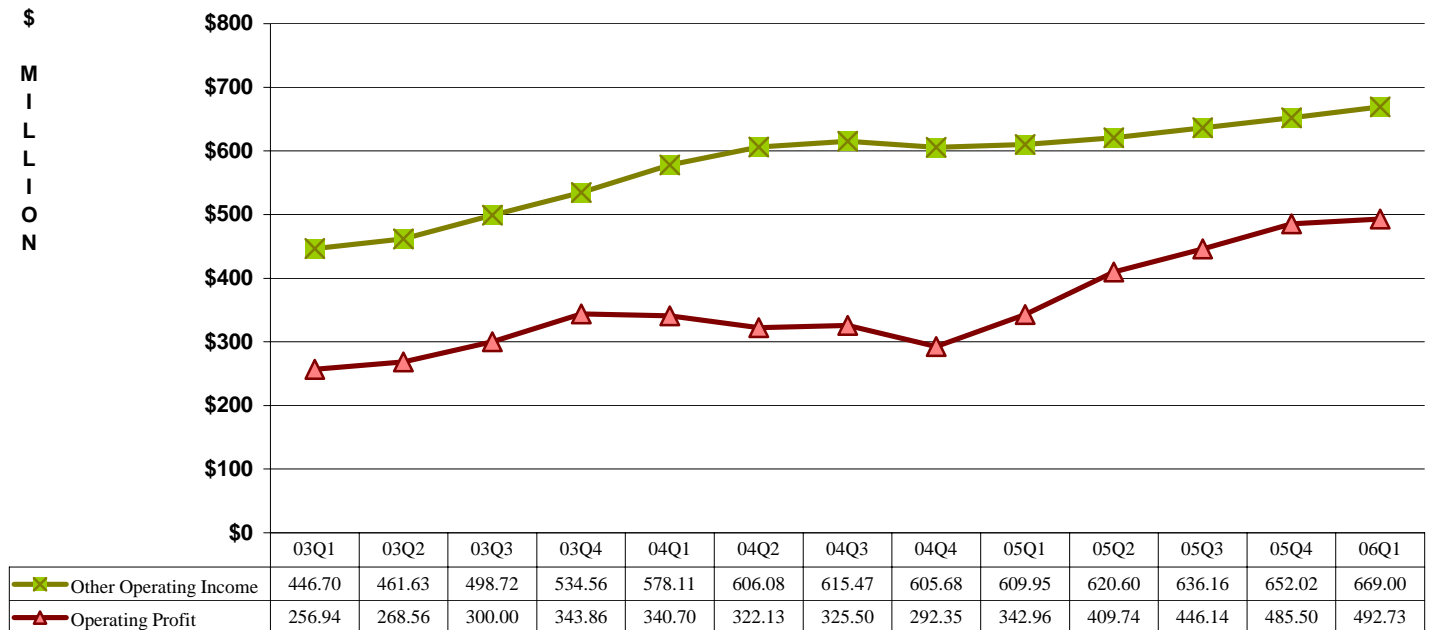


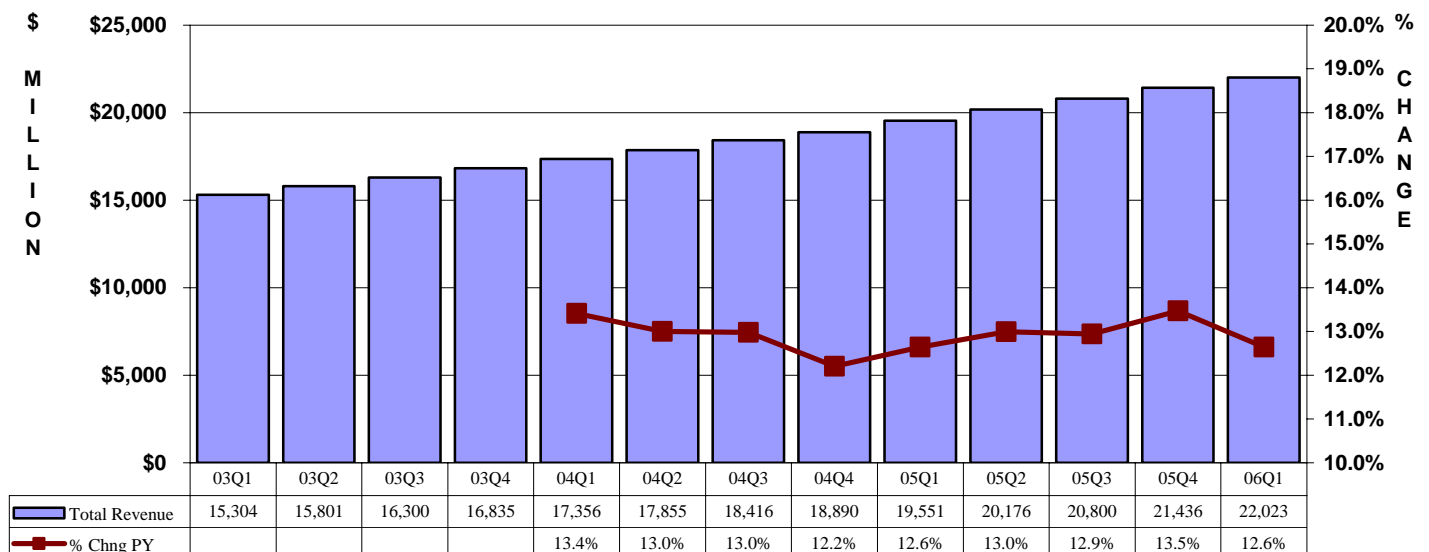
Chart: While other operating income is included in the mix to calculate operating profit, operating profit without the other operating income is relatively small in comparison and so other operating income is a larger amount in total.

FINANCIAL INDICATORS

Total Patient Service Revenue

Total billed charges for patient services, which is identified as total patient service revenue or total revenue, increased by \$2.5 billion from \$19.5 billion to \$22.0 billion for the period ending March 31, 2006. The annual increase rate of 12.6% is slightly smaller than recent rates. The annual dollar increase has been greater than \$2 billion each four quarter year for the past four years.

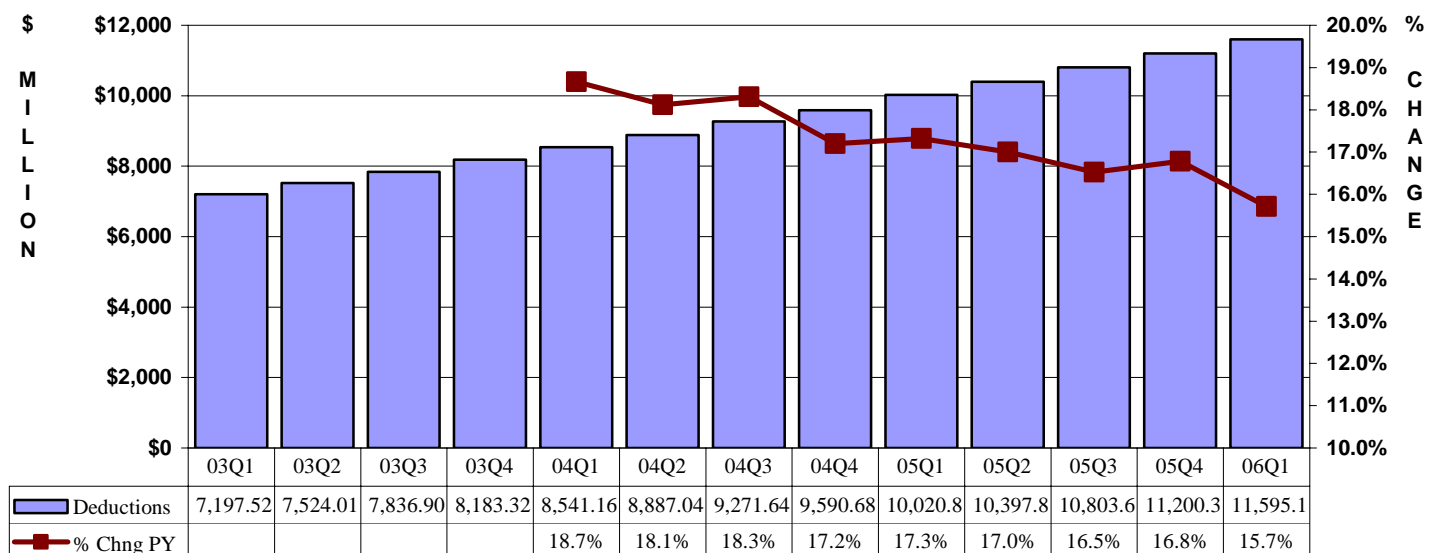
Total Patient Service Revenue



Total Deductions from Revenue

For the twelve months ended March 31, 2006 total deductions from revenue reached \$11.6 billion. This was an increase of \$1.6 billion, or 15.7%, over the previous period ending March 31, 2005. Total deductions from revenue have been more than 50% of total patient service revenue since the four quarters ending September 30, 2004. Total deductions include contractual adjustments and charity care.

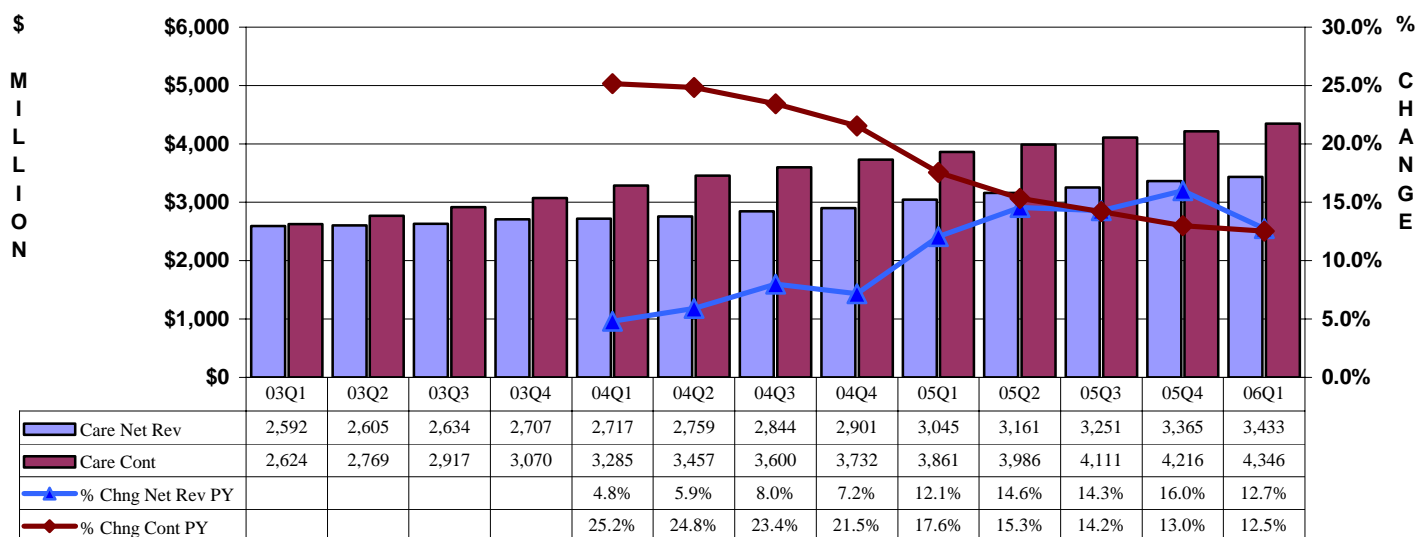
Total Deductions from Revenue



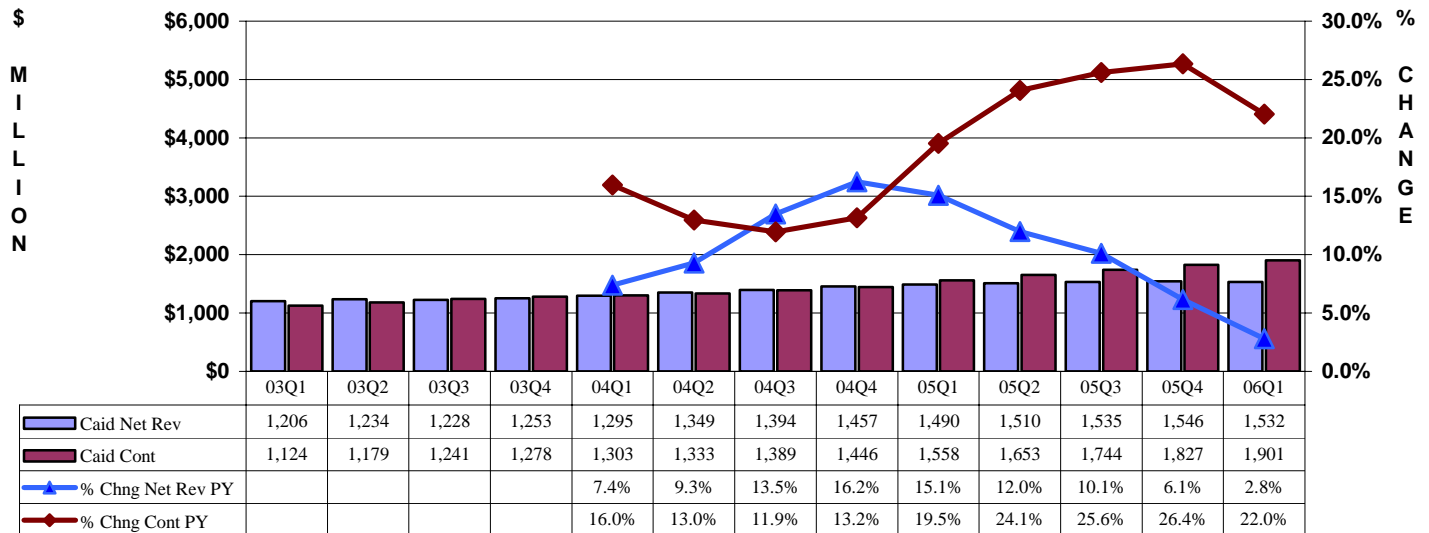
Contractual Adjustments

Contractuals, the most significant part of deductions from revenue, vary by payer. Below are three graphs, one for each payer, Medicare, Medicaid and Other. The three graphs are set up so you can see the relative size of the contractual adjustments and the net revenue by payer. The chart shows net revenue and contractuals and the percentage change for each over the prior year period. Other payer has the largest portion of net revenue, \$6.0 billion and deductions of \$4.8 billion. Medicare's net revenue of \$3.4 billion is much less than Other, however the contractuals are similar to Other at \$4.3 billion. Medicaid net revenue was \$1.5 billion and deductions were \$1.9 billion. Based on the hospital's rate sheet, or billed revenue, hospitals bill Medicare an average of \$2.27 for each dollar they receive, Other payers an average of \$1.80 and Medicaid an average of \$2.24.

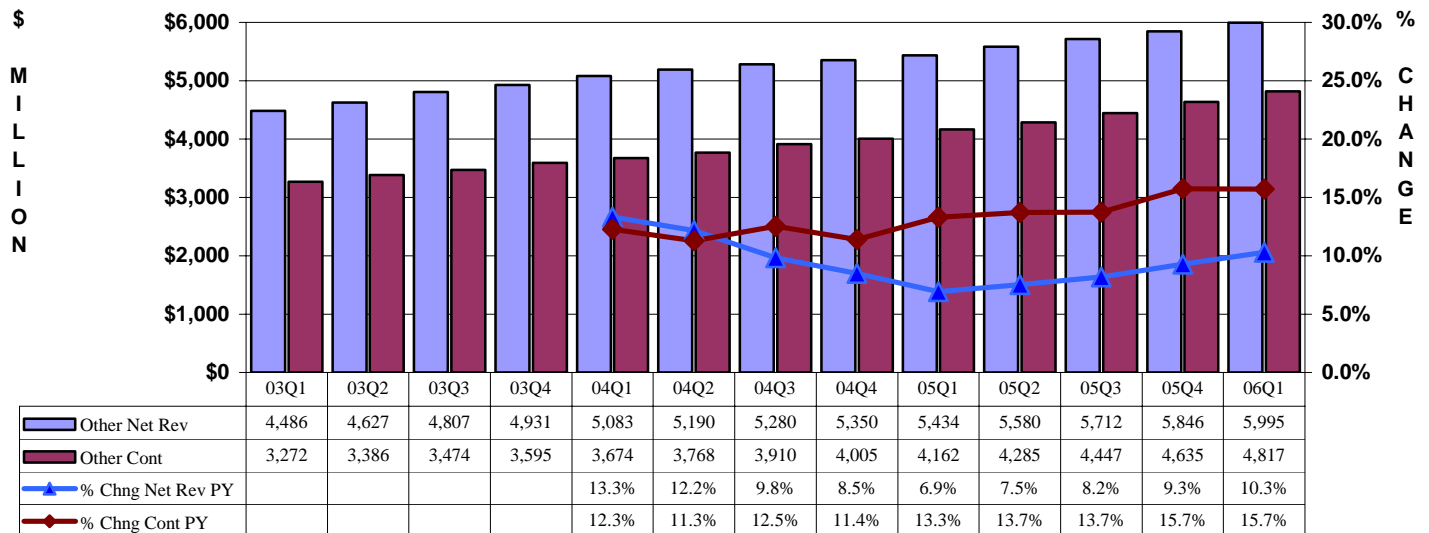
Medicare Contractuals



Medicaid Contractuals



Other Contractuals



Uncompensated Care

Uncompensated care is composed of charity care and bad debt expense. While charity care is part of the deductions from revenue category and bad debt is part of the operating expenses, they are similar. Each represents billed charges for hospital services that are not paid. Charity care represents charges that are not paid by patients who are **unable** to pay, while bad debt expense arises from charges that are not paid by patients who are **unwilling** to pay. During this four quarter cycle, charity care has grown by 21.0% and bad debt has increased by 2.3%, for a total increase in uncompensated care of 11.7%.

Charity

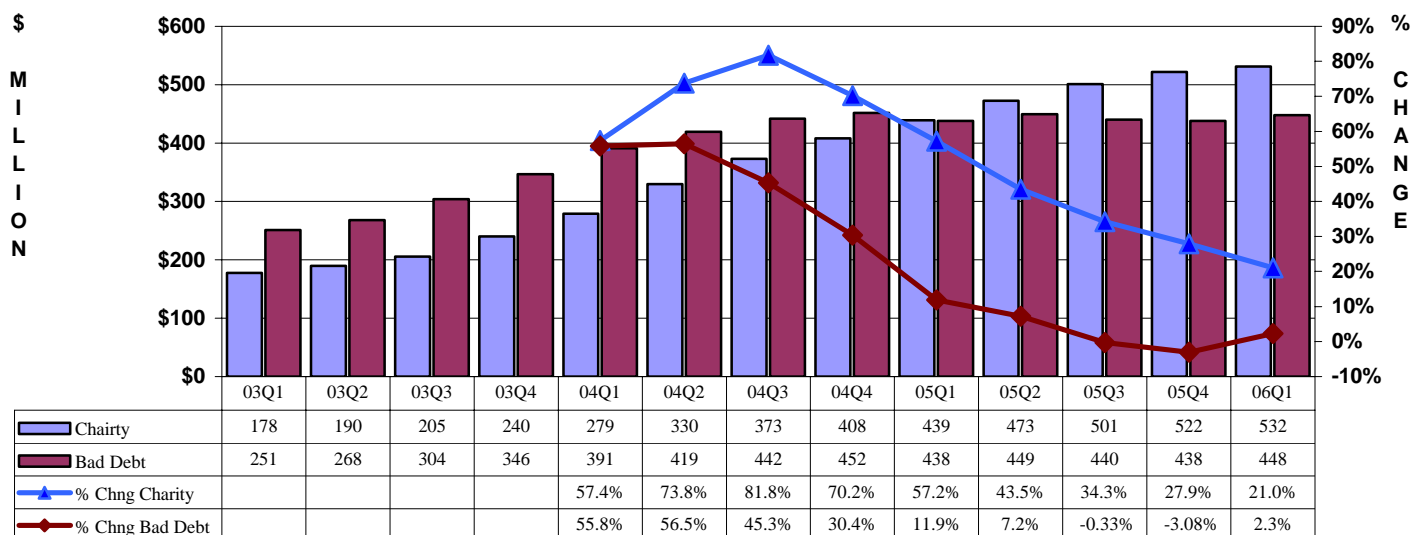
While charity care is only 2.41% of billed revenue, the dollar amount and percentage have been growing very rapidly during the past five years. Comparing the four quarters ending March 31, 2003 to the four quarters ending March 31, 2006 shows a \$354 millions increase or 198%. During the March 31, 2005 to March 31, 2006 period, charity care has increased 21%. Even though the increase was sizable, it is the smallest increase in several years.

Bad Debt

The bad debt dollar amount has grown from \$438 million for the four quarters ending March 31, 2005 to \$448 million for the period ending March 31, 2006 which is a 2.3% increase. The high mark was the period ending December 31, 2004 at \$452 million. The dollar amount declined to \$435 million twice before rising

slightly to this current \$448 million. Bad debt total dollars have been less than those of charity care since the period ending March 31, 2005. Prior to that time bad debt always was a larger dollar amount.

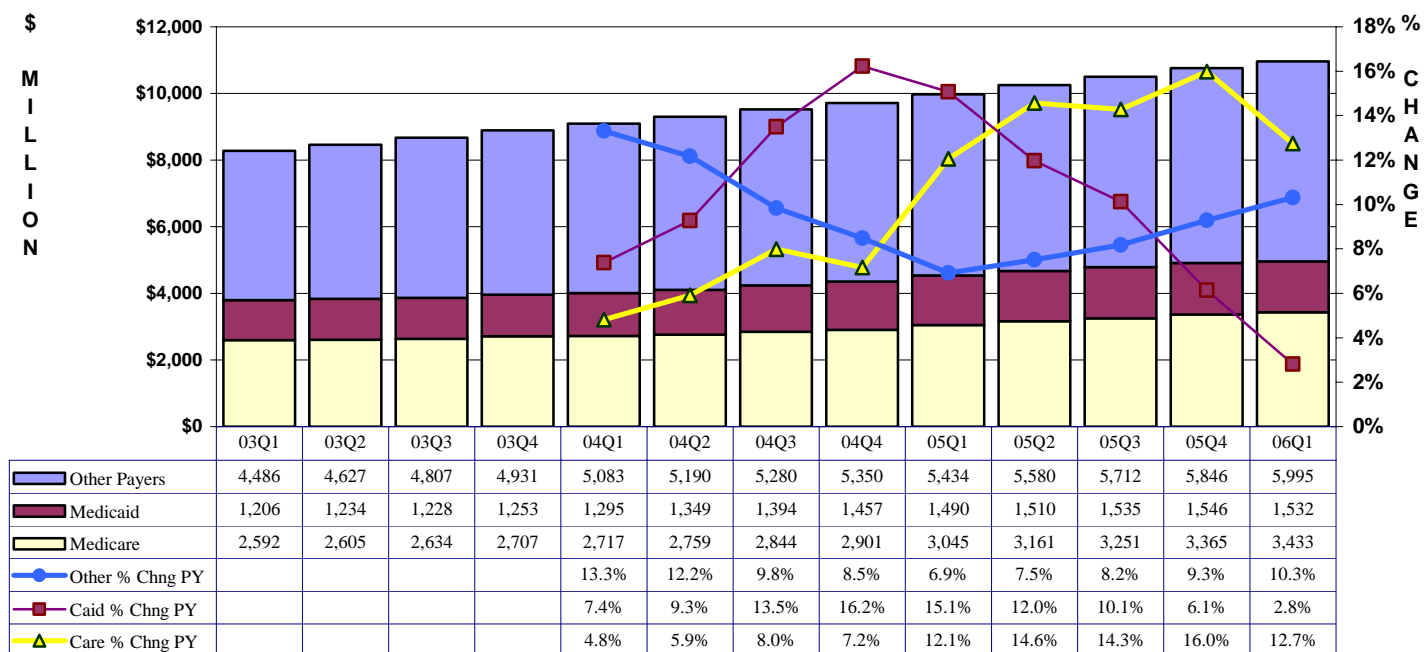
Charity and Bad Debt



Net Patient Services Revenue

During the twelve month period ended March 31, 2006 net patient service revenue grew by 9.4%, or \$898 million, from \$9.5 billion to \$10.4 billion. Medicare's percent growth increased from the prior period, however both Medicaid and Other had smaller percentage increases from the previous period. The percentage change by payer from the previous year period shows that Medicare had a 12.7% increase, Other had a 10.3% and Medicaid had a 2.8% increase over the twelve month period ending March 31, 2005.

Net Patient Service Revenue by Payer

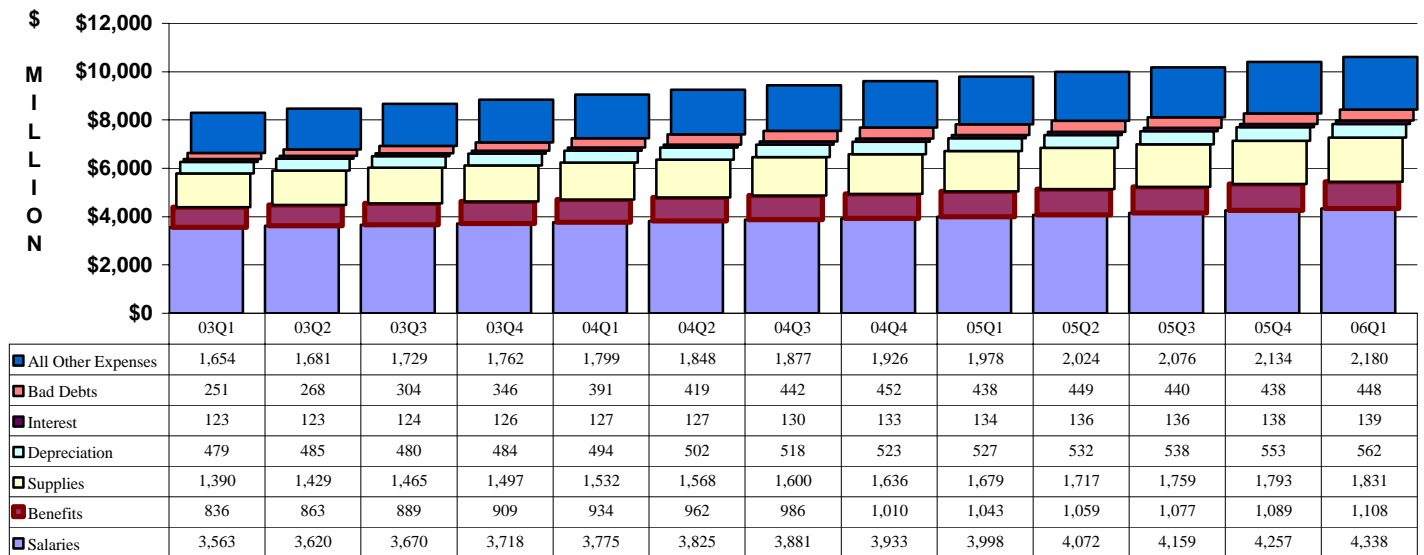


Operating Expenses

Growing by 8.2%, or \$807 million, operating expenses reached \$10.6 billion in the twelve month period ended March 31, 2006. Adjusted admissions only increased 3.6% during the same time period. Operating expenses are the costs of providing health care services to hospital patients. The 8.2% increase exceeded the 3.4% annual increase in the overall consumer price index and the 5.9% annual increase in the hospital services component of the index for the same time period of March 2005 to March 2006. CPI information is at

this link <http://ftp.bls.gov/pub/news.release/History/cpi.04192006.news>. The category with the largest dollar increase in operating expenses between the four quarters ending March 31, 2005 and March 31, 2006 was salaries at 8.5% or \$339 million for a total of \$4,338 million. The category with the largest percentage increase in operating expenses between the four quarters ending March 31, 2005 and March 31, 2006 was all other expenses at 10.2%, or \$201 million for a total of \$2,180 million. Interest expense and bad debt expense had the smallest dollar and percentage increase respectively during the same period.

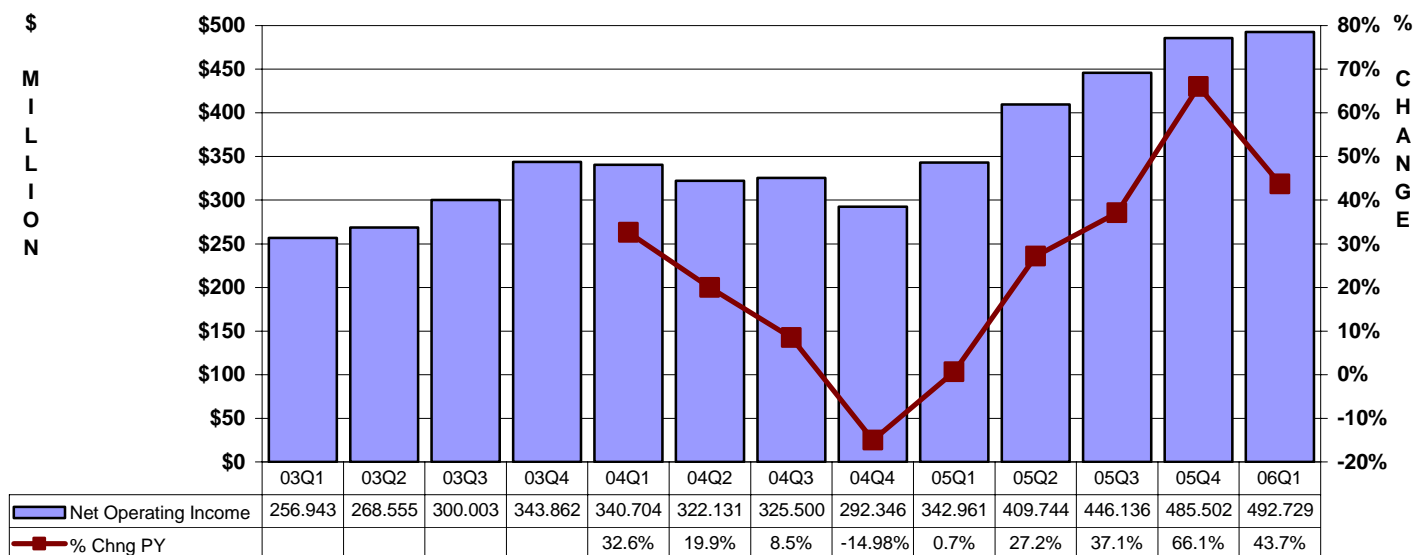
Operating Expense



Net Operating Income

During the four quarters ended March 31, 2006 net operating income advanced to \$493 million, which was up 43.7% over the year ago level. Net operating income is volatile due to the large dollars that are involved in the calculation. A small change in the ratio of operating income, which grew 9.4% and operating expense, which grew 8.2%, caused the 43.7% change in net operating income. Net operating income includes other operating income. There were 38 hospitals that had an operating loss at this point in the income statement and 57 hospitals had a profit. The hospital total margin which includes tax revenue, extraordinary income and non-operating income results in 20 hospitals with an overall loss and 75 hospitals with a profit.

Net Operating Income

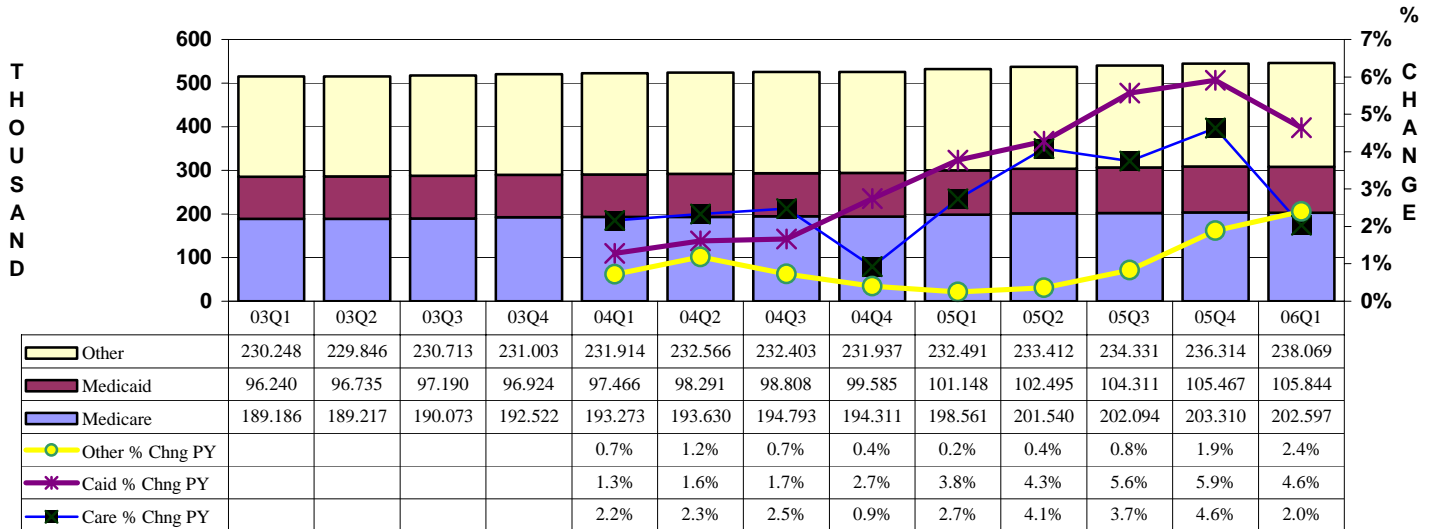


UTILIZATION INDICATORS

Discharges

Discharges and patient days are the primary indicators of inpatient activity. Discharges continued to grow, reaching a total of 546,510 discharges during the four quarters ending March 21, 2006. This was a gain of 14,310 discharges, or 2.69%, over the corresponding 2005 period. Medicaid had significantly larger growth than Medicare and Other. Other, for the first time since the 1997-1998 period had growth above 2%.

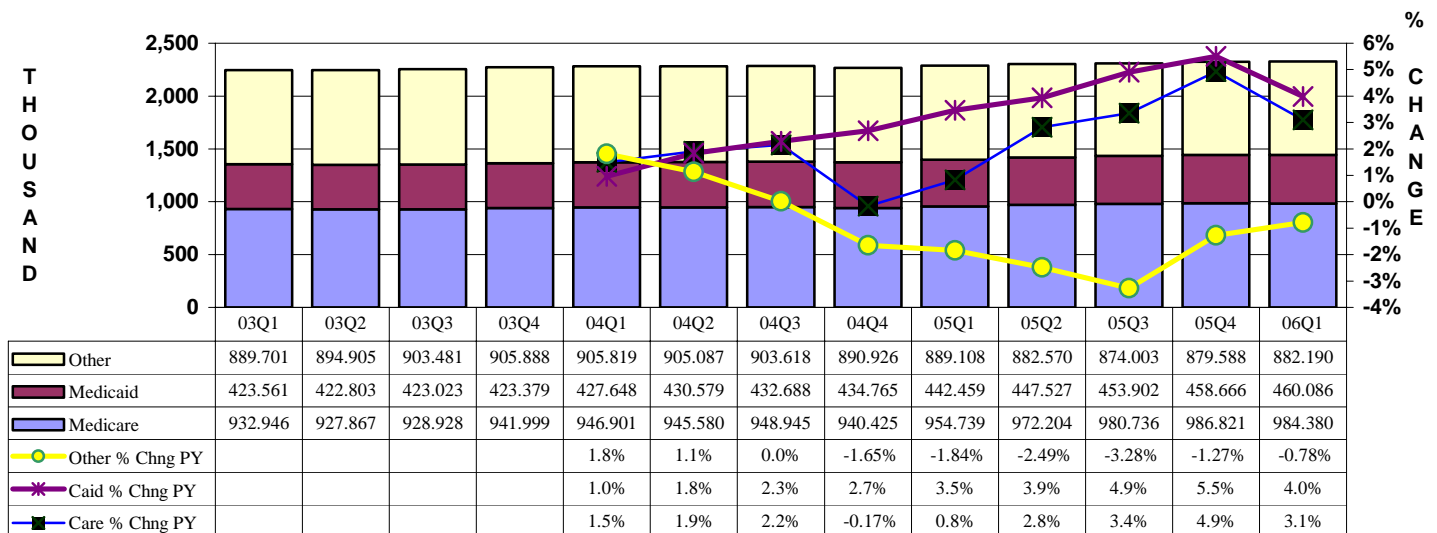
Discharges by Payer



Patient Days

Patient days also continued to grow, reaching a total of 2,326,656 during the four quarters ending March 21, 2006. This was a gain of 40,350 patient days, or 1.76%, over the corresponding year ago period. Medicare days grew 3.1%, Medicaid days grew 4.0% and Other declined by .8%. Other days peaked at 905,888 days during the four quarters ending September 30, 2004.

Patient Days by Payer

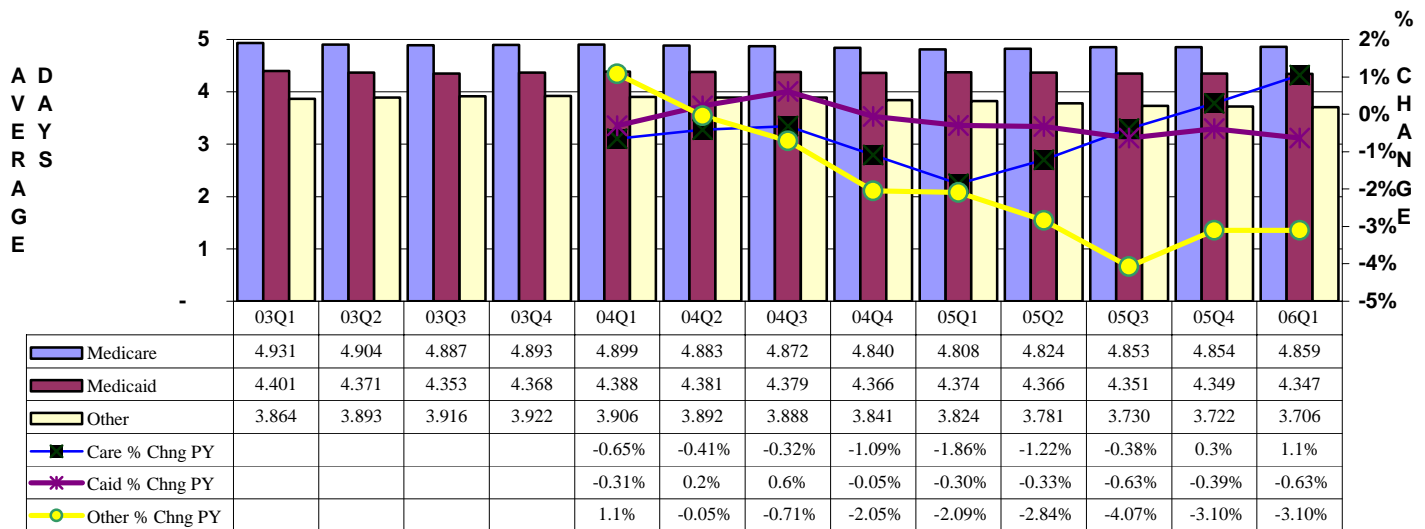


Length of Stay

Since the percentage increase in statewide discharges during the four quarters ending March 21, 2006 exceeded the increase of patient days, statewide average length of stay declined slightly to 4.26 days, or .9%. Statewide average length of stay (ALOS) had remained in the range of 4.37 days to 4.24 days from calendar year 1995 through 2006 first quarter. During the four quarters ended March 31, 2006 the average length of stay has declined by .04 days from the previous period ending March 31, 2005. In the latest period, Medicare

average length of stay was 4.86, Medicaid was 4.35 and Other was 3.73. Medicare ALOS was 11.8% higher than Medicaid and 31.1% higher than Other payer.

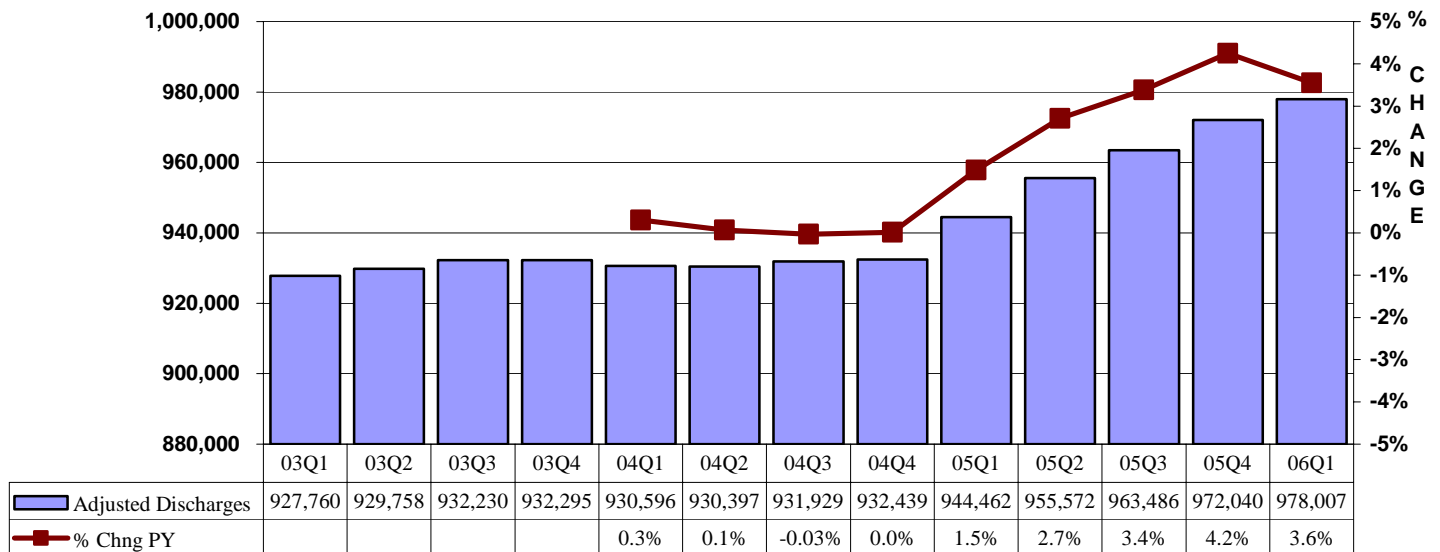
Length of Stay by Payer



Adjusted Discharges

Adjusted discharges reached a total of 978,007 in the four quarter period ended March 31, 2006. This was an increase of 33,544 adjusted discharges, or 3.6%, from the four quarter period ended March 31, 2005. The percentage increase was down slightly from the largest one year increase in adjusted discharges in over 10 years for the calendar year 2005 over the calendar year 2004. Adjusted discharges were created as a proxy for total hospital volume since discharges only count inpatients. Adjusted discharges, within the quarterly system, are calculated by increasing discharges by the percent of inpatient revenue to total revenue.

Adjusted Discharges

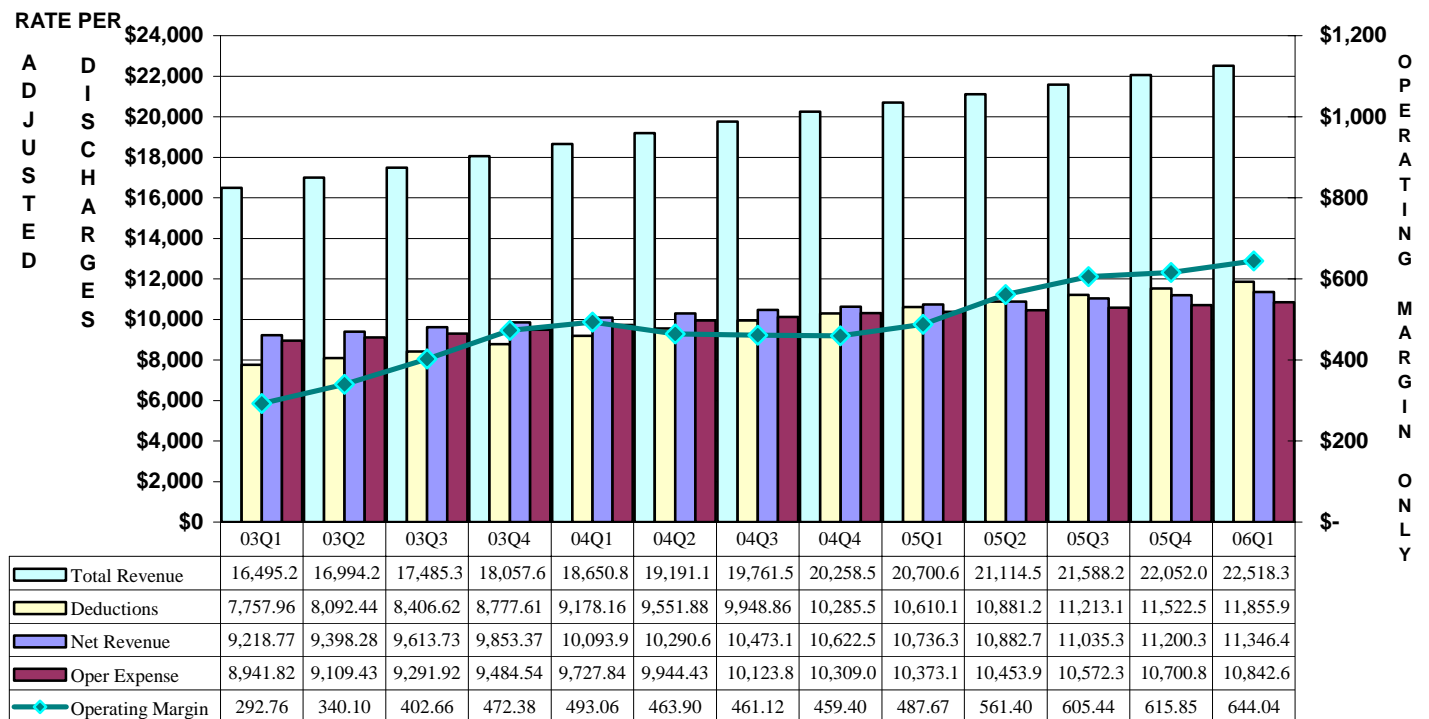


OPERATING INDICATORS

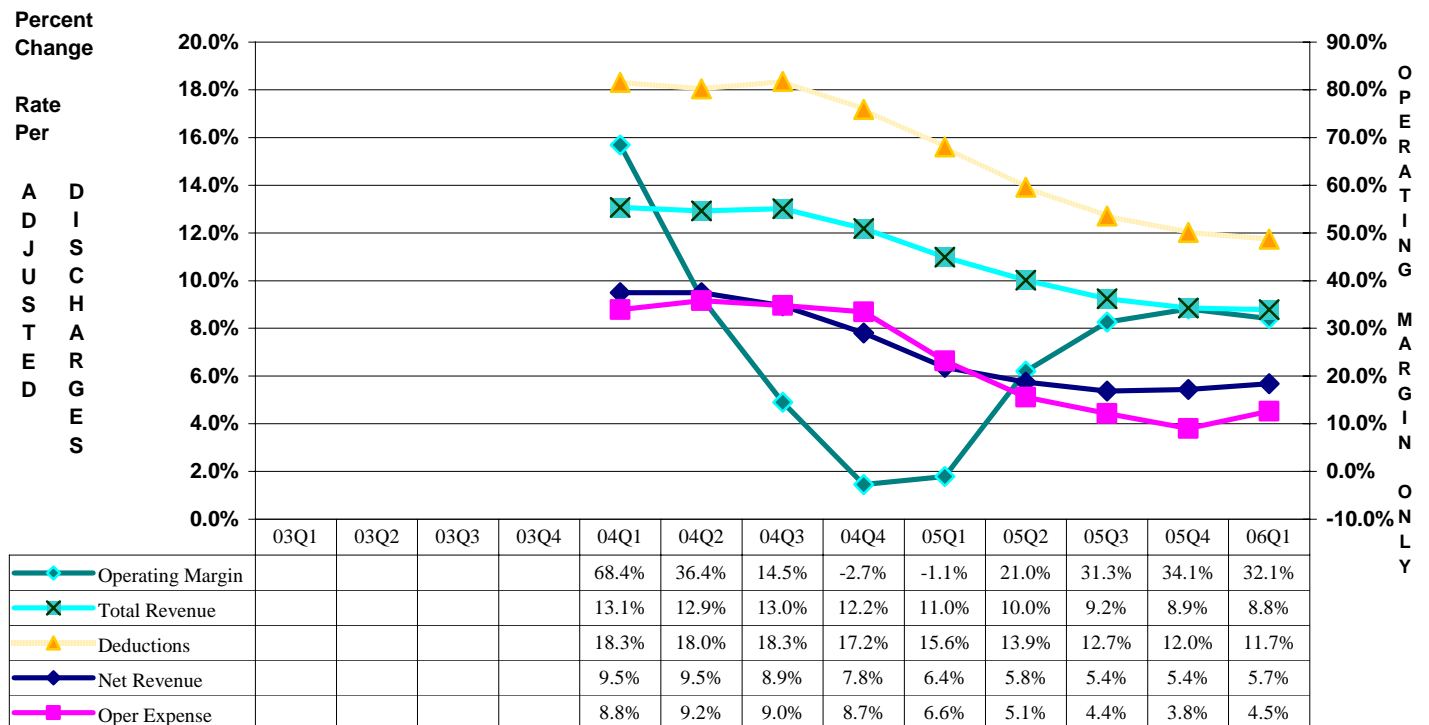
Rates per Adjusted Discharge

When you take the total dollar amounts for various categories and divide by the adjusted discharge count, you get an average rate per adjusted discharge. This formula removes volume fluctuation from the review and makes it easier to look at other factors. While the dollar amount of rates continues to rise each period, the percentage increase is on a slight downward swing, except for net profit which is currently on a rise. Note the continued large increase of deductions as it becomes a bigger number than net revenue. Total or billed revenue is becoming less relevant each year as it is now more than twice the actual dollar amount collected.

Rate per Adjusted Discharge



Percent Change - Rate per Adjusted Discharge



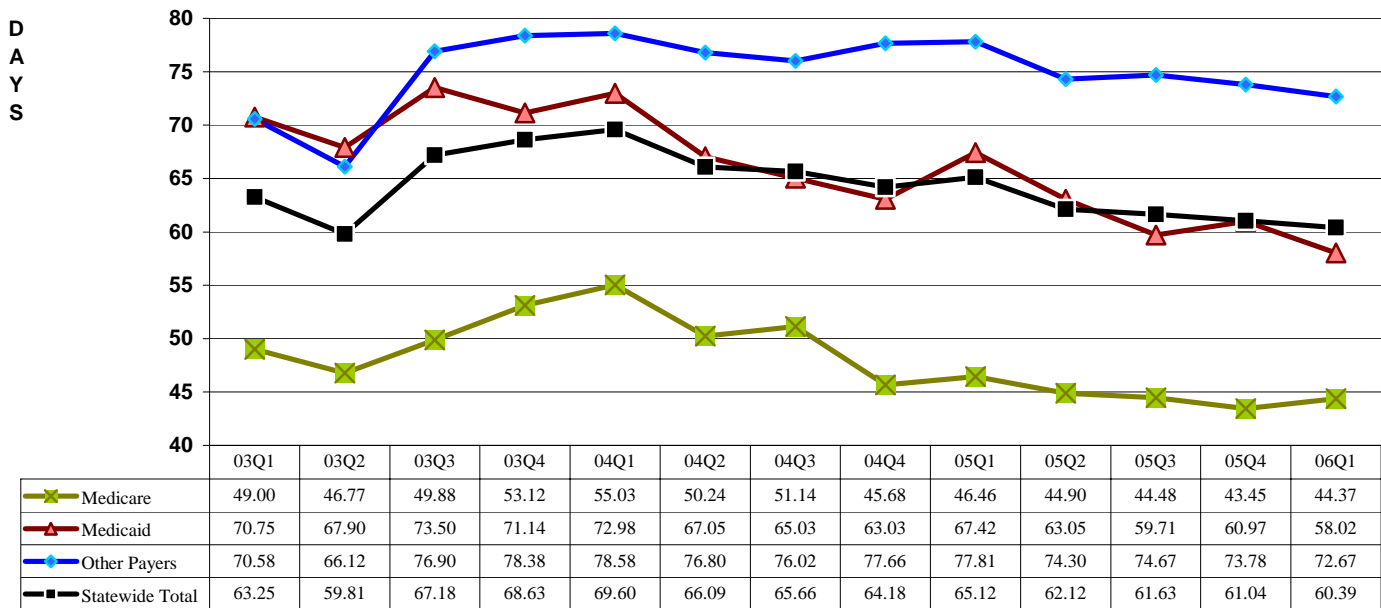
FINANCIAL RATIOS

The relationships between financial indicators are reflected by financial ratios. The financial ratios selected for this report are not all encompassing, but represent financial indicators that can be readily calculated from the data available through the quarterly reporting process as currently designed without requesting supplemental data from the reporting hospitals.

Days in Accounts Receivable

Accounts receivable is the largest item in the current assets portion of the balance sheet for most hospitals. Days in accounts receivable is a measure of how "current" this asset is. In this report days in accounts receivable is calculated on an annual gross basis. Shorter days or smaller numbers are more desirable. On a statewide basis, accounts receivable averaged 60.4 days for the four quarter period ending March 31, 2006. This was a reduction of 4.7 days, or 7.3%, from the corresponding year earlier period. Medicare accounts receivable decreased by 2.1 days, or 4.5%, to 44.4 days. Accounts receivable for Medicaid dropped by 9.4 days, or 13.9%, to 58.0 days. A reduction of 5.1 days, or 6.6%, to an average of 72.7 days was also noted for the Other payer groups.

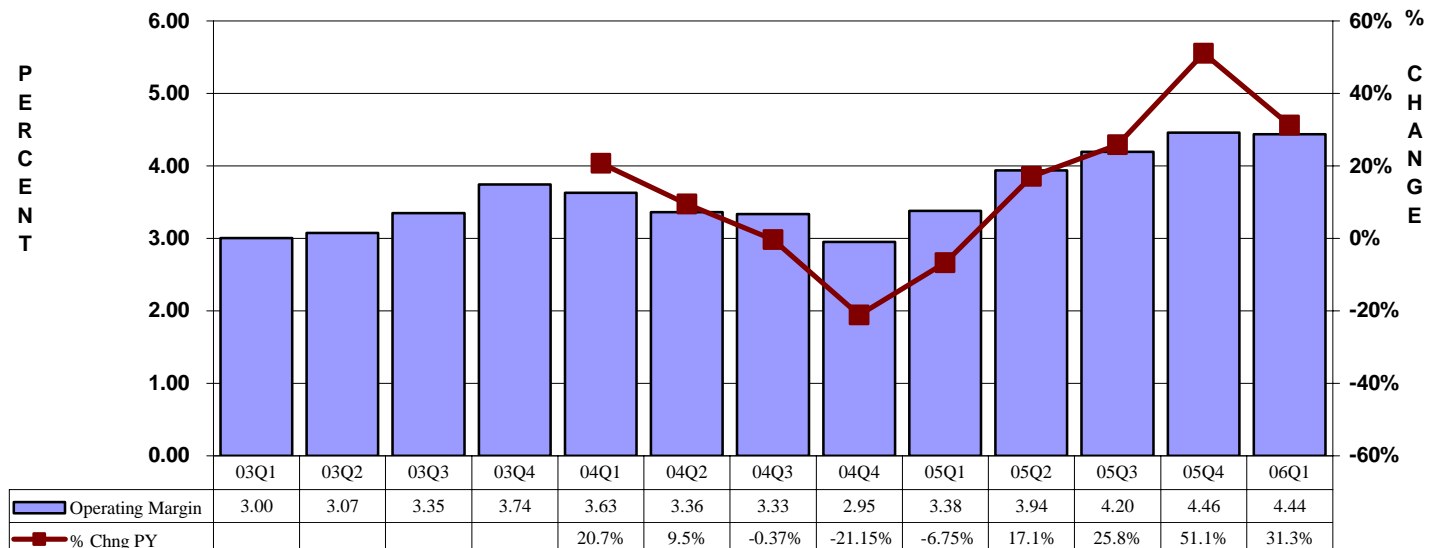
Days in Accounts Receivable by Payer



Operating Margin

During the twelve month period ended March 31, 2006 operating margin reached 4.44%, which was 31% above the year earlier level. The current period is slightly below the highest recent level of 4.46 which is from the four quarters ending December 31, 2005. The low was 1.4% for the four quarters ending December 31, 2000. Operating margin includes patient revenue and other operating revenue.

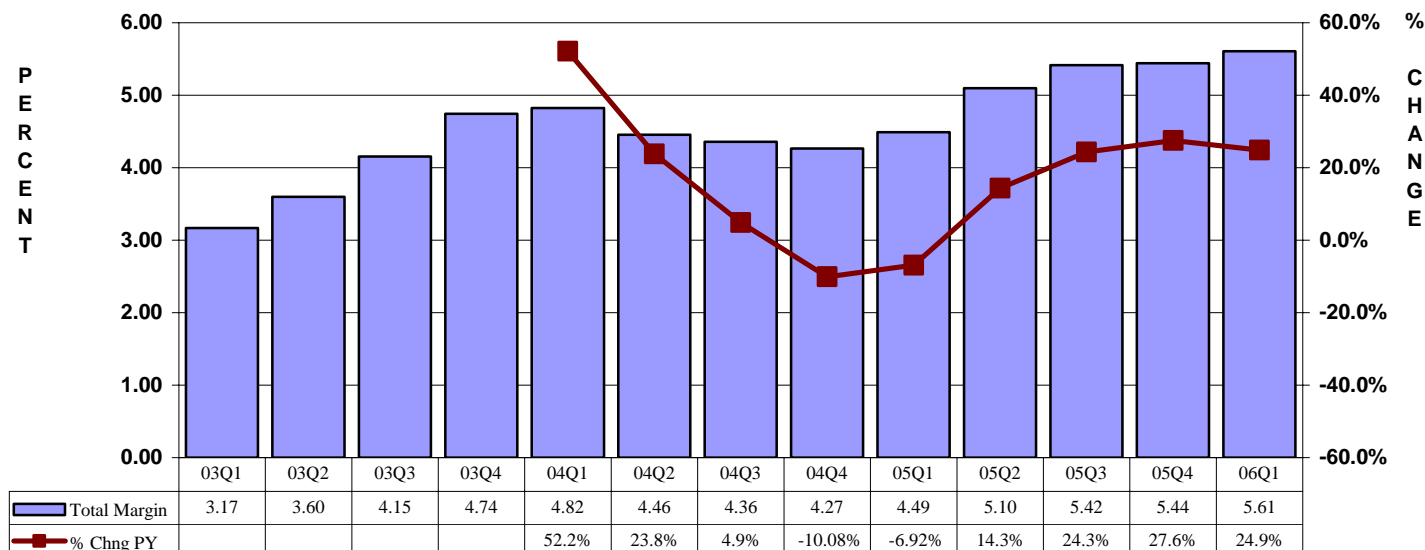
Operating Margin



Total Margin

During the twelve month period ending March 31, 2006 operating margin reached 5.6%, which was 24.9% above the year earlier level. The 5.6% has not been achieved in the past 10 years. The recent low of 1.9% was for the year 2000. Total margin includes operating margin plus extraordinary items, federal income taxes and non operating income.

Total Margin



Deductible Proportion

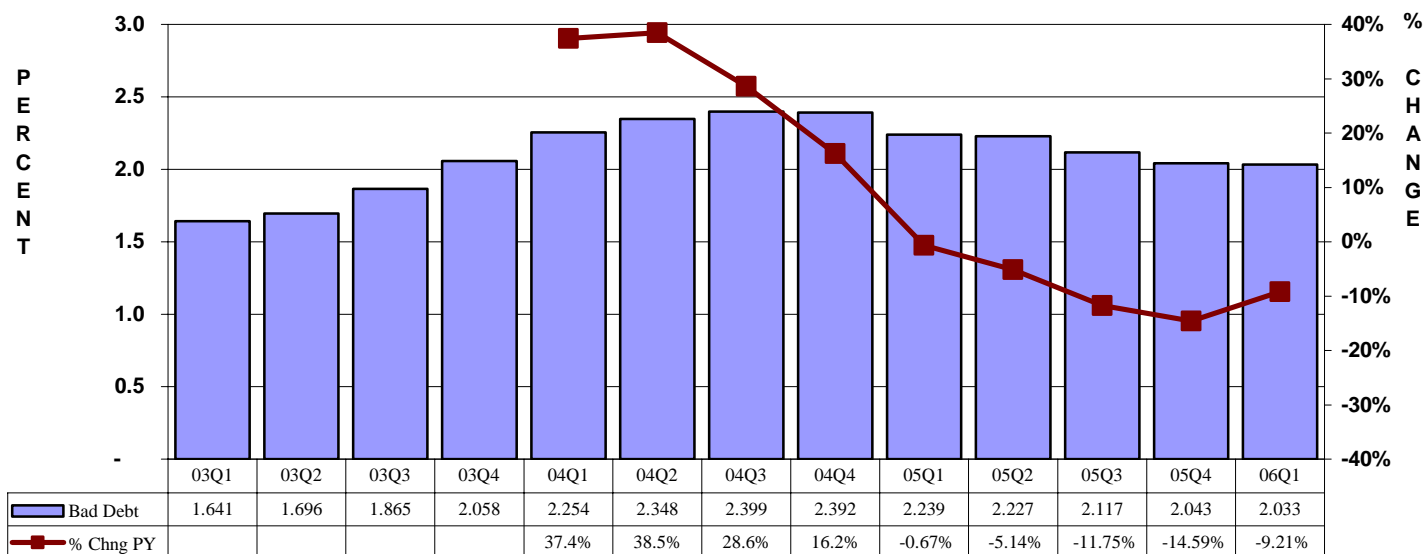
Uncompensated Care Proportion

The bad debt proportion, charity proportion, and total uncompensated care proportion, compare bad debt expense, charity care, and total uncompensated care to total patient service revenue. The total uncompensated care proportion reached 4.45%, which was a decline of .87% over the previous year because bad debt had a very small actual dollar increase.

Bad Debt

In the four quarter period ended March 31, 2006, the bad debt proportion reached 2.03%, which was an decrease of 9.2% from the previous year. This continued a decline in this ratio of five periods in a row.

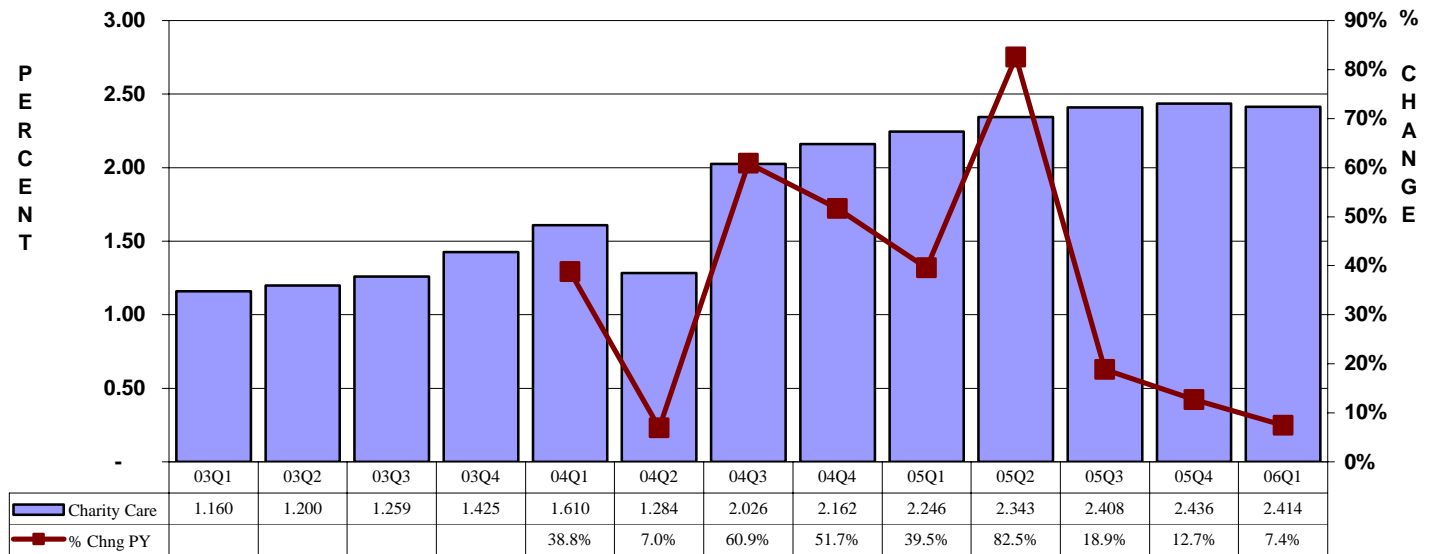
Bad Debt as a Percent of Total Revenue



Charity Care

The charity care proportion reached 2.41%, which was an increase of 7.4% over the previous year and was a slight decline from the previous period which was the highest noted since the beginning of our data.

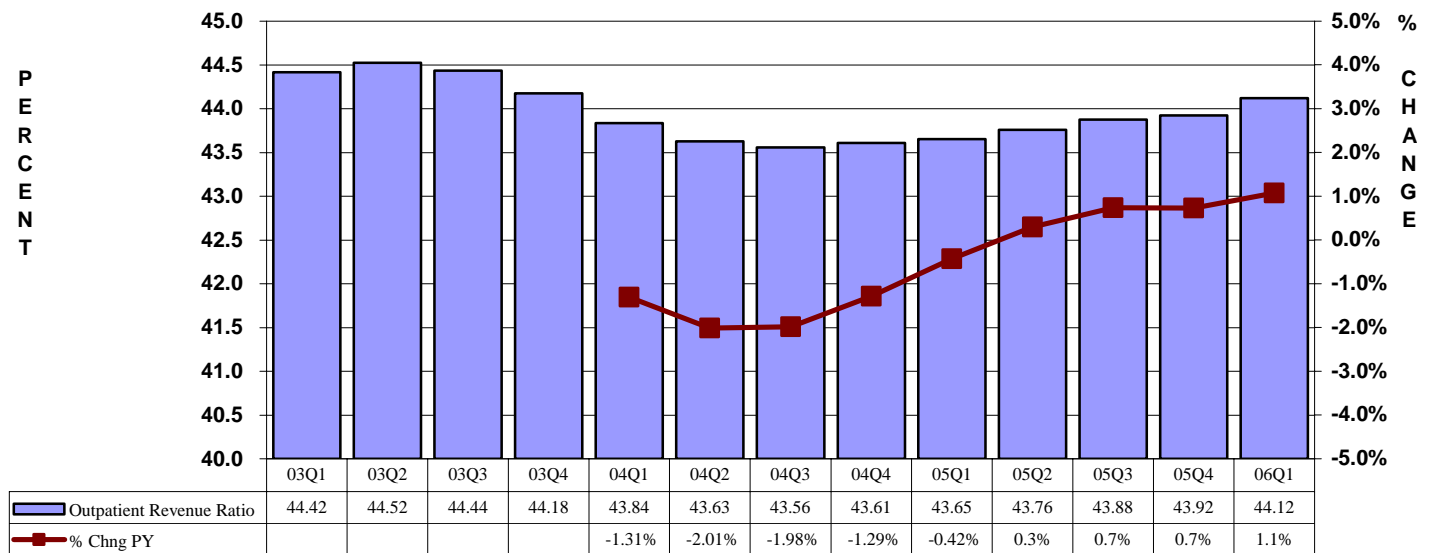
Charity Care as a Percent of Total Revenue



Inpatient and Outpatient Revenue

The outpatient revenue percentage is a way of looking at the relationship between inpatient and outpatient revenue. It is a rough indicator of the change in treatment locations. Between the annual periods ended March 31, 2005 and March 31, 2006 the outpatient revenue percentage increased from 43.7% to 44.1%, or 1.1%. As hospitals moved procedures from inpatient to outpatient setting over the years, the ratio has gone up dramatically. In 1987 the ratio was 24.2%. Recently the ratio has been between 43 and 45.

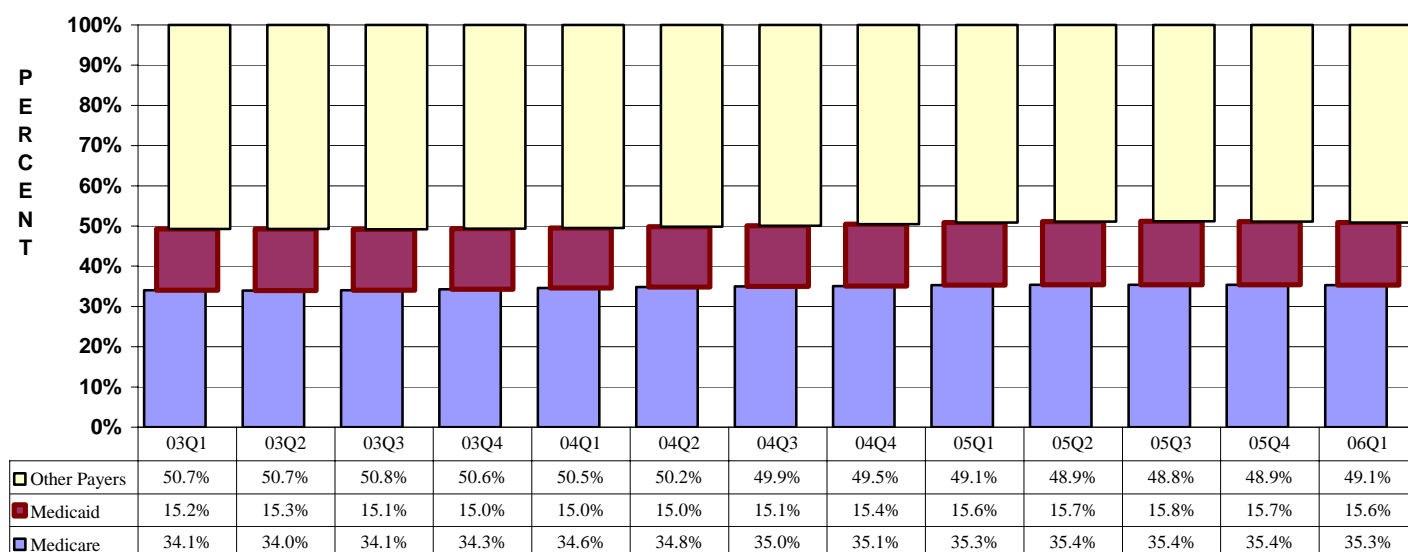
Outpatient Revenue as a percent of Total Revenue



Medicare and Medicaid Revenue

The Medicare billed revenue percentage and the Medicaid billed revenue percentage indicate the proportion of total hospital business that these programs represent. In the four quarter period ended March 31, 2006 the Medicare percentage was 35.3%, an decrease of 0.01% over the same period in 2005. This is the first decline in the Medicare percent in several years. The Medicaid percentage was 15.6% which is unchanged from the previous period ending March 31, 2005. With 50.9% of total patient service revenue, the Medicare and Medicaid programs have a major influence on the financial health of hospitals. Other payer revenue increased less than 0.01% from 48.9% during the period ending March 31, 2005 to 49.1% for the period ending March 31, 2006.

Medicare and Medicaid Revenue proportion by Payer



Notes: Information

For more detailed information you can visit the Department of Health - Hospital and Patient Data web site at <http://www.doh.wa.gov/EHSPHL/hospdata> for a large variety of hospital data and reports. Included are hospital financial data and reports, hospital discharge data and reports, and Charity Care reports. Also included are Directory of Hospitals, CHARS Procedure Manual, *Accounting and Reporting Manual for Hospitals*, Charity Care reports and past *hospTRENDS*.

Your comments and suggestions for improvement would be greatly appreciated. Please let us know what you like or don't like about the content and presentation of the *hospTRENDS* report. Contact information is on the last page.

Background

All licensed hospitals in the State of Washington submit summary financial and utilization data to the Department of Health following each calendar quarter. Reported data are edited, summarized, and analyzed by Hospital and Patient Data Systems staff. Specific data elements are defined in the Department's *Accounting and Reporting Manual for Hospitals*. Utilizing these data, various financial and utilization rates and ratios are calculated to enhance the description of the financial condition of hospitals in the state. The purpose of this series of reports is to provide information describing emerging hospital utilization and financial trends to all concerned parties.

Rather than focusing on individual calendar quarters, the data in this report are aggregated into twelve month periods consisting of four calendar quarters each. This aggregation reduces the impact of seasonal fluctuations, which could distort actual trends occurring within the hospital industry.

The period covered by this report includes the last three quarters of 2005 and the first quarter of 2006. However, this preview is subject to change. The quarterly reports submitted by hospitals contain interim data which have not yet been subjected to audit review. Future adjustments and/or revisions as a result of both the hospital's internal accounting system review and the formal procedures of outside auditors may result in changes to previously submitted data. These future revisions will be reflected in the hospital's year-end reports. The year-end reports not only reflect audit adjustments but also provide substantially greater detail, which allows analysis of the information provided in-- greater depth.

HOSPITAL PERFORMANCE STATEWIDE	12 Mo. Ended Mar 31 2005	12 Mo. Ended Mar 31 2006	Total Change	Percent Change
Total Patient Revenue				
Inpatient	11,016,876,839	12,306,522,562	1,289,645,723	11.71%
Outpatient	8,534,093,509	9,716,607,057	1,182,513,548	13.86%
Total	19,550,970,348	22,023,129,619	2,472,159,271	12.64%
Medicare	6,906,530,747	7,778,879,665	872,348,918	12.63%
Medicaid	3,047,719,452	3,432,690,521	384,971,069	12.63%
Other	9,596,720,149	10,811,559,433	1,214,839,284	12.66%
Deductions From Revenue				
Contractual Adjustments				
Medicare	3,861,488,739	4,345,635,366	484,146,627	12.54%
Medicaid	1,557,915,523	1,901,075,802	343,160,279	22.03%
Other	4,162,300,212	4,816,943,807	654,643,595	15.73%
Total	9,581,704,474	11,063,654,975	1,481,950,501	15.47%
Charity	439,166,005	531,538,976	92,372,971	21.03%
Total	10,020,870,479	11,595,193,951	1,574,323,472	15.71%
Uncompensated Care				
Bad Debt	437,799,752	447,723,317	9,923,565	2.27%
Charity	439,166,005	531,538,976	92,372,971	21.03%
Total	876,965,757	979,262,293	102,296,536	11.66%
Net Patient Revenue				
Medicare	3,045,042,008	3,433,244,299	388,202,291	12.75%
Medicaid	1,489,803,929	1,531,614,719	41,810,790	2.81%
Other	5,434,419,937	5,994,615,626	560,195,689	10.31%
Total	9,530,099,869	10,427,935,668	897,835,799	9.42%
Other Operating Revenue	609,947,401	668,999,511	59,052,110	9.68%
Total Operating Revenue	10,140,047,270	11,096,935,179	956,887,909	9.44%
Total Operating Expenses	9,797,086,689	10,604,206,476	807,119,787	8.24%
Net Operating Income	342,960,581	492,728,703	149,768,122	43.67%
Non-Operating Income	96,920,126	117,238,426	20,318,300	20.96%
Tax Revenue	20,706,349	19,906,116	(800,233)	-3.86%
Net Total Income	460,587,056	629,873,245	169,286,189	36.75%
Gross Accounts Receivable				
Medicare	879,194,689	945,567,152	66,372,463	7.55%
Medicaid	562,956,213	545,684,970	(17,271,243)	-3.07%
Other	2,045,784,302	2,152,607,343	106,823,041	5.22%
Total	3,487,935,204	3,643,859,465	155,924,261	4.47%
Days in Accounts Receivable				
Medicare	46.5	44.4	(2.1)	-4.51%
Medicaid	67.4	58.0	(9.4)	-13.94%
Other Payers	77.8	72.7	(5.1)	-6.60%
Statewide Total	65.1	60.4	(4.7)	-7.26%
Utilization				
Discharges	532,200	546,510	14,310	2.69%
Patient Days	2,286,306	2,326,656	40,350	1.76%
Length of Stay	4.30	4.26	(0.04)	-0.90%
Adjusted Discharges	944,462	978,007	33,544	3.55%
Rates per Adjusted Discharge				
Total Revenue	20,700.63	22,518.38	1,817.75	8.78%
Deductions	10,610.13	11,855.95	1,245.82	11.74%
Net Revenue	10,736.32	11,346.48	610.17	5.68%
Operating Expense	10,373.19	10,842.67	469.49	4.53%
Net Margin	487.67	644.04	156.37	32.06%
Financial Ratios				
Operating Margin	3.38	4.44	1.06	31.28%
Total Margin	4.49	5.61	1.12	24.87%
Deductible Proportion	51.26	52.65	1.39	2.72%
Contractual Proportion - Total	49.01	50.24	1.23	2.51%
Contractual Proportion - Medicare	55.91	55.86	(0.05)	-0.08%
Contractual Proportion - Medicaid	51.12	55.38	4.26	8.34%
Contractual Proportion - Other	43.37	44.55	1.18	2.72%
Bad Debt Proportion	2.24	2.03	(0.21)	-9.21%
Charity Proportion	2.25	2.41	0.17	7.45%
Uncompensated Care Proportion	4.49	4.45	(0.04)	-0.87%
Total Revenue/Inpatient Revenue	1.77	1.79	0.01	0.84%
Outpatient Revenue Percent	43.65	44.12	0.47	1.08%
Medicare Revenue Percent	35.33	35.32	(0.00)	-0.01%
Medicaid Revenue Percent	15.59	15.59	(0.00)	-0.01%

hospTRENDS

Washington State

Community Hospital Financial and Utilization Trend Update
Quarter Ended March 31, 2006

For additional information, comments, and suggestions,
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